United States Bankruptcy Court
Southern District of Florida

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Stephan Jay Lawrence, Debtor
Bankruptcy Case No. 97-14687-BKC-AJC

United States Bankruptcy Court
S.D. Florida, Miami Division

June 2, 2000

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Chad P. Pugatch, P.A., Fort Lauderdale, FL, for Rosenthal, Rosenthal, Rasco, Stok & Wolf.
Michael I. Goldberg, Akerman, Senterfitt & Eidson, P.A., Fort Lauderdale, FL, for Brian Behar and Behar, Gutt & Glazer, P.A.
Kenneth B. Robinson, Rice & Robinson, P.A., Miami, FL, for Rosenthal, Rosenthal, Rasco.

Thomas S. Utschig, United States Bankruptcy Judge.

ORDER GRANTING IN PART AND DENYING IN PART DISPOSITIVE MOTIONS AND MOTIONS TO STRIKE THE MOTION FOR SANCTIONS BY ALAN GOLDBERG, TRUSTEE

Presently before the Court are a variety of pleadings which raise legal challenges to the trustee's motion to impose sanctions against Robert A. Stok, the law firm of Rosenthal, Rosenthal, Rasco, Stok & Wolf, P.A., Brian Behar, the law firm of Behar, Gutt & Glazer, P.A., and Stephan Jay Lawrence pursuant to 28 U.S.C. § 1927, 11 U.S.C. § 105(a), Rule 9011 of the Federal Rules of Bankruptcy Procedure, and local bankruptcy rules 2090-2(A) and (B). The pleadings which have been filed in response to the trustee's motion for sanctions include Rosenthal, Rosenthal, Rasco, Stok & Wolf's motion to dismiss and/or strike; Rosenthal, Rosenthal, Rasco's motion to dismiss; debtor/defendant's memorandum of law in opposition to the motion for sanctions; Brian Behar and Behar, Gutt & Glazer, P.A.'s motion to strike; and Robert A. Stok's motion to strike and dismiss.

The requisite facts and procedural history are as follows. When Stephan Jay Lawrence filed for bankruptcy, Robert A. Stok represented him. During the course of what can with understatement be termed a hotly contested case, Lawrence had his discharge denied as a discovery sanction and was held in contempt for failing to turn over the corpus of what has come to be called the "Mauritian trust."[(1)] A number of matters remain pending on appeal, including the contempt citation against the debtor and the trustee's objection to the debtor's claimed exemption regarding certain pension funds. As this case has unfolded, it is clear that the debtor's litigation philosophy has been to compel the trustee to litigate every issue. The question is whether those tactics have crossed the line from legitimate arguments to abuse of the judicial process, and, if so, who should bear the responsibility for the resulting legal costs.

The trustee brought the motion for sanctions to collect what he believes to have been fees and costs which were needlessly incurred as a result of several stratagems employed by the debtor, either to oust the trustee's counsel or to prevent certain discovery. The trustee submits that the debtor and Stok knowingly advanced frivolous and meritless arguments in connection with several motions to disqualify the trustee's counsel, as well as in various discovery matters. The trustee argues that the debtor was joined in this course of conduct by Brian Behar, who was engaged to represent the debtor's mother when the trustee sought to depose her and determine what, if anything, she knew about the Mauritian trust (as she was a putative beneficiary of the trust). The trustee also seeks to extend liability for these fees and costs to the law firms of both attorneys, as well as the debtor himself.

Without addressing the merits of the trustee's claims, the objecting parties contend that regardless of the nature of the offending conduct, the trustee's motion must be denied for various legal reasons. First, they contend that the trustee did not comply with the so-called "safe harbor" provisions of the recent revisions to Fed. R. Bankr. P. 9011. They submit that 28 U.S.C. § 1927 cannot be applied in this case because the bankruptcy court is not a "court of the United States" within the meaning of that statute. They argue that the Court cannot issue sanctions under 11 U.S.C. § 105(a) because the trustee could have complied with Rule 9011 and did not do so. They argue that the Court cannot issue sanctions for conduct which occurred before other tribunals (namely, the District Court and the Court of Appeals). And lest the kitchen sink be forgotten, each party also raises certain objections which are peculiar to themselves alone. [(2)]

The Court first turns to the issue of Rule 9011. There has been some discussion of which version of the rule to apply. The version in effect when the debtor filed bankruptcy on June 12, 1997, did not contain a safe harbor provision. However, the version which took effect on December 1, 1997, provides that a motion for sanctions may not be filed unless within 21 days after service of the motion "the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected." See Fed. R. Bankr. P. 9011(c)(1)(A). While the trustee is correct that the revised version of the rule is not automatically retroactive, the Supreme Court's order approving the amendments provides that they shall apply not only to cases commenced after December 1, 1997, but also "as just and practicable, all proceedings in bankruptcy cases then pending." See April 11, 1997 Order of the Supreme Court relating to 1997 Amendments to the Fed. R. Bankr. P.

The Court agrees with the objecting parties that there is nothing unjust or impracticable about imposing the revised rule in this case. While the trustee suggests that the offending conduct could not have been discovered in time to supply the 21-day notice, that is an argument which goes more to the propriety of sanctions under § 105(a) and is not a basis for limiting the effect of the Supreme Court's directive. Therefore, as the trustee concedes that no notice was given, the Court concludes that sanctions may not be awarded under Rule 9011. [(3)]

The trustee also seeks an award of sanctions under 28 U.S.C. § 1927. This section provides that:

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably

incurred because of such conduct.

The Court's ability to award sanctions under this provision hinges upon whether it is a "court of the United States." As admitted by debtor's counsel during argument, this Court is clearly a court authorized by Congress which sits "in" the United States. However, there is a body of case law which holds that bankruptcy courts are not "courts of the United States" within the meaning of 28 U.S.C. § 451, the statute which defines the phrase as "includ[ing] the Supreme Court of the United States, courts of appeals, district courts constituted by chapter 5 of this title . . . and any court created by Act of Congress the judges of which are entitled to hold office during good behavior." See In re Courtesy Inns, Ltd., Inc., 40 F.3d 1084 (10th Cir. 1994); In re Perroton, 958 F.2d 889 (9th Cir. 1992); In re Regensteiner Printing Co., 142 B.R. 815 (N.D. Ill. 1992).[4]

If the objecting parties are correct, the Court cannot award sanctions under this provision. They cite this Court to two Eleventh Circuit decisions, In re Brickell Inv. Corp., 922 F.2d 696 (11th Cir. 1991) and In re Davis, 899 F.2d 1136 (11th Cir. 1990) in support of their proposition and argue that these decisions are binding authority. Both of these cases do indeed hold that a "court of the United States" within the meaning of 28 U.S.C. § 451 must be an Article III court. It is undisputed that a bankruptcy court is not an Article III court. Brickell Inv. Corp., 922 F.2d at 699. Therefore, the reasoning follows, such courts are not "courts of the United States" and may not exercise the authority found in a variety of federal statutes (28 U.S.C. § 1927 is only one such statute, and was not at issue in either of the cited decisions).

However, this Court is persuaded by the reasoning in such cases as In re Grewe, 4 F.3d 299 (4th Cir. 1993), cert. denied, 510 U.S. 1112 (1994), and In re Brooks, 175 B.R. 409 (Bankr. S.D. Ala. 1994). While the objecting parties argue that Brickell Inv. Corp. and Davis are binding precedent which cannot be ignored, the Court is mindful of the fact that neither decision considers the analysis which is subsequently put forth in both Grewe and Brooks. See Brooks, 175 B.R. at 412. In Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598 (1982), the Supreme Court held that Congress had "impermissibly removed" essential attributes of judicial power from the Article III district courts and vested those powers in Article I bankruptcy courts which were "functionally independent" from the district court. Id. at 87, 102 S. Ct. at 2880. In response to the ruling that this system was unconstitutional, Congress altered the bankruptcy code and made bankruptcy courts "units of the district court" pursuant to 28 U.S.C. § 151.

Unlike the Tax Court or other such Article I courts, bankruptcy courts do not exist as separate and distinct judicial entities. All bankruptcy jurisdiction flows from the district court, which "refers" matters to the bankruptcy courts. As the Grewe court states, Congress intended that this jurisdictional scheme would "remedy the problems depicted in Marathon by eliminating the 'functional independence' of the bankruptcy court, and instead making it a mere division of the district court." 4 F.3d at 304. Under this structure, federal district courts exercise original jurisdiction over *all* "matters and proceedings in bankruptcy," 28 U.S.C. § 1334, and bankruptcy judges "serve as judicial officers of the United States district court established under Article III of the Constitution." 28 U.S.C. § 152(a)(1). Bankruptcy matters are then referred to the bankruptcy courts from the district courts. 28 U.S.C. § 157. For jurisdictional purposes, however, there is only one court -- the district court. Grewe, 4 F.3d at 304; see also Yochum, 89 F.3d at 668 ("because bankruptcy courts are units of the district court, they are covered under [§ 451]'s aegis").

As such, the bankruptcy court's ability to award sanctions under 28 U.S.C. § 1927 flows from its jurisdictional relationship with the district court. The district courts are clearly "courts of the United States," and bankruptcy courts operate as units or divisions of that court. The failure to denominate bankruptcy courts in § 451 is irrelevant because, unlike the Tax Court and the Claims Court, bankruptcy courts do not exist for jurisdictional purposes outside the umbrella of the district court. Grewe, 4 F.3d at 304-5; Chambers, 140 B.R. at 237. Accordingly, the Court concludes that the trustee may seek an award of sanctions under this provision.

In the alternative, the trustee seeks an award of sanctions under 11 U.S.C. § 105(a), which provides that:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

The trustee contends that this section essentially codifies the Court's "inherent" power to sanction conduct which is abusive of the judicial process. The objecting parties contend that the Court cannot utilize this section to award sanctions. Their reasoning is somewhat vague, but the argument is basically that since the trustee could have sought sanctions under Rule 9011 had he simply complied with the safe harbor provisions, § 105(a) cannot be used to excuse his failure to do so.

This argument presumes too much. Most notably, it ignores the trustee's contention that he did not have sufficient factual grounds to dispute the allegations made by counsel during the disqualification proceedings. It also fails to consider that the trustee's allegations hint at a course of conduct, rather than a singular pleading. The trustee complains not just of one brick, but of the wall built with those bricks. Given the serious nature of the allegations, they must be dealt with on the merits. In In re Courtesy Inns, Ltd., Inc., 40 F.3d 1084 (10th Cir. 1994), the court first concluded that sanctions were not appropriate under either 28 U.S.C. § 1927 or Rule 9011. Indeed, the Court stated that "[a] strict reading of Rule 9011 would deny the bankruptcy court jurisdiction . . . to sanction [the party in question]." Nonetheless, the court proceeded to hold that the bankruptcy court had an alternative method for sanctions -- namely, the court's "inherent power."

The Supreme Court has recognized the inherent power of a federal court to sanction conduct which is abusive of the judicial process. Id. at 1089; see also Chambers v. NASCO, Inc., 501 U.S. 32, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991). In Chambers, the Supreme Court rejected an argument that statutes and rules such as § 1927 or Rule 9011 in any manner displaced this inherent power. It held that:

> [W]hen there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute nor the Rules are up to the task, the court may safely rely on its inherent power.

Id. at 50, 111 S. Ct. at 2136. While the objecting parties suggest that bankruptcy courts somehow lack this power, this Court agrees with the Tenth Circuit that "[t]he power to maintain order and confine improper behavior in its own proceedings seems a necessary adjunct to any tribunal charged by law with the adjudication of disputes."

Courtesy Inns, 40 F.3d at 1089; see also Matter of Volpert, 110 F.3d 494, 501 (7th Cir. 1997) (the plain language of § 105 furnishes bankruptcy courts with "ample authority to sanction conduct that abuses the judicial process, including conduct that unreasonably and vexatiously multiplies bankruptcy proceedings"). Further, the suggestion that the trustee could have complied with Rule 9011 is disingenuous and does not adequately consider the allegation of an abusive course of conduct.[(5)] Inherent power should be exercised "only when necessary," but the Court concludes that this case is one instance where the exercise of that power is appropriate. Chambers, 501 U.S. at 64, 111 S. Ct. at 2143.[(6)]

In this regard, it would appear that neither the statute nor the rule are "up to the task." Chambers, 501 U.S. at 50, 111 S. Ct. at 2136. The trustee contends that it was impossible for him to determine that the statements and arguments of counsel were meritless until significantly after they occurred.[(7)] The trustee also argues that this is not a case where one pleading is false or vexatious, but rather one in which the debtor and his counsel engaged in an extended course of vexatious conduct. Accordingly, it is not easy to fit this scenario into Rule 9011. As a result, while Rule 9011 cannot apply in this case under a "strict" reading of the safe harbor provision, and even presupposing that this Court is "in" the United States but not "of" the United States, the Court concludes that it is appropriate to consider an award of sanctions under 11 U.S.C. § 105(a).

The objecting parties also contend that this Court cannot award sanctions for conduct or statements made before either the District Court or the Court of Appeals. They cite In re Rolls Constr. Corp., 108 B.R. 807 (Bankr. S.D. Fla. 1989); Barr Lab. Inc. v. Abbott Lab., 867 F.2d 743 (2d Cir. 1989); and In re Westin Capital Markets, Inc., 184 B.R. 109 (Bankr. D. Or. 1995), in support of this proposition. Rolls Constr. Corp. involved a party who sought sanctions before a Florida bankruptcy court for conduct which occurred in a bankruptcy court in another state, and is therefore distinguishable from the present case. Nonetheless, the Court generally agrees with the decision in Westin Capital.

The Westin Capital court states "the proper court to impose sanctions for filing an appeal is the court hearing the appeal . . . [and] this court . . . may award sanctions . . . only for conduct occurring prior to the appeal." 184 B.R. at 119. Therefore, to the extent the trustee seeks sanctions for statements or conduct made while prosecuting an appeal before the District Court or the Court of Appeals, this Court is not the proper forum. However, this does not mean that those statements cannot be considered in determining whether conduct before this Court may be sanctioned. Given the trustee's claim that the parties involved embarked upon a course of bad faith conduct, the statements of those parties while prosecuting the same claim on appeal certainly constitute relevant evidence on that issue. Accordingly, the trustee may not seek sanctions for the prosecution of the appeal, but may introduce the statements of counsel as evidence to document the allegedly sanctionable conduct in this Court, and may seek compensation for discovery pertaining to the underlying issues while the appeal was pending.[(8)]

The objecting parties' other arguments can be disposed of in relatively short order. Brian Behar argues that he should not be sanctioned for events which took place after he terminated his representation of the debtor's mother. Yet he points to no evidence in the record that this termination was ever transmitted to other parties. Nor is there any evidence, other than his own affidavit, that he did not authorize someone at the Stok firm to sign pleadings on his behalf. These are factual issues, and can only be determined at a hearing on the merits.

Similarly, the law firms of Rosenthal, Rosenthal, Rasco and Rosenthal, Rosenthal, Rasco, Stok & Wolf may not so easily escape liability. It may well be that Rosenthal, Rosenthal, Rasco is a separate and distinct entity from the so-called "predecessor" firm of Rosenthal, Rosenthal, Rasco, Stok & Wolf, but it may also be responsible under a theory of successor liability. Likewise, Rosenthal, Rosenthal, Rasco, Stok & Wolf may no longer exist; if so, that fact may be established at an evidentiary hearing.[(9)] It is impossible for the Court to issue a ruling on these matters on the present record, as it contains nothing more than the conclusory arguments of counsel.

Further, while the debtor is correct in his assertion that he cannot be sanctioned under 28 U.S.C. § 1927 as he is not an attorney, it remains too early to decide whether he would be subjected to a double sanction were one imposed under 11 U.S.C. §105(a). The debtor's discharge was denied for certain specific discovery abuses; whether he should suffer a monetary penalty for other conduct is an issue the Court will consider on the merits. Quite simply, the path this case has taken has been at the debtor's instigation. If the representations of counsel were misleading and made with the intent to delay and vexatiously multiply the litigation, it appears appropriate to question whether the debtor should bear some responsibility for the resulting legal miasma.

The Court concludes that notwithstanding the legion of legal arguments interposed against the trustee's motion, the motion for sanctions shall proceed to evidentiary hearing. The Court has the power, be it under 11 U.S.C. § 1927, 11 U.S.C. § 105(a), or its inherent power as a tribunal "charged by law with the adjudication of disputes," to award sanctions if it appears that the parties engaged in bad faith conduct or conduct which is abusive of the judicial process. This Court does not consider the issue of sanctions lightly; rather, sanctions are generally to be abhorred. See Meadowbriar Home for Children, Inc. v. Gunn, 81 F.3d 521 (5th Cir. 1996) (award of fees against attorney who unreasonably and vexatiously multiples proceedings is to be sparingly applied); Nowosad v. English, 903 F. Supp. 377 (E.D. N.Y. 1995) (sanctions should be considered with great caution).

Parties and their counsel are entitled to vigorously present their case and make such arguments as support their position. GTE North, Inc. v. Communication Workers of America, Local 4773, 927 F. Supp. 296 (N.D. Ind. 1996) (no sanction for raising colorable, though unsuccessful legal argument). But where a party or an attorney acts in bad faith, or knowingly makes statements which are without merit or are interposed simply to multiply litigation, the Court is obligated to consider sanctions as a mechanism to "maintain order and confine improper behavior." Courtesy Inns, 40 F.3d at 1089. The trustee raises serious allegations about the conduct of attorneys who practice before this Court. They must be addressed.

Accordingly,

IT IS ORDERED that the various motions to strike and memorandums in opposition to the trustee's motion for sanctions are granted in part and denied in part. While the trustee may not seek sanctions under Rule 9011, he may do so under 28 U.S.C. § 1927 and 11 U.S.C. § 105(a). The matter is scheduled for an evidentiary hearing at 9:30 a.m. on August 9, 2000, where the Court shall consider the conduct at issue and make an appropriate determination regarding the liability, if any, of the various parties.

Dated: June 2, 2000.

END NOTES:

1. Lawrence funded this trust prior to his bankruptcy with some uncertain sum of money (allegedly in the range of $7 million). During the course of this proceeding, the trust was ruled to constitute an asset of Lawrence's bankruptcy estate. See In re Lawrence, 227 B.R. 907 (Bankr. S.D. Fla. 1998). While the debtor contends that this trust was created to safeguard his retirement security, he remains unperturbed that the trustee of the trust has allegedly removed him as a beneficiary and placed the funds beyond his reach forever. This absurd contradiction, together with his complete lack of candor regarding his financial affairs, resulted in the denial of his discharge.

2. For example, Brian Behar contends that he should not be held responsible for any conduct which occurred after he allegedly ceased representing Fredrica Lawrence, and states that he never authorized anyone else to sign his name to pleadings. The debtor suggests that to sanction him for the conduct outlined in the trustee's motion would essentially constitute a double sanction, in that he has already suffered the denial of his discharge as a sanction for discovery abuse. The law firms of Rosenthal, Rosenthal, Rasco, Stok & Wolf and Rosenthal, Rosenthal, Rasco suggest that they have no liability for the alleged sanctionable conduct in that the former firm no longer exists and the latter is not a successor entity chargeable with Stok's conduct.

3. Because of this ruling, the Court need not address whether Rule 9011 sanctions can be awarded for the so-called "discovery abuses," and does not do so.

4. Interestingly, some of the same jurisdictions cited by the objecting parties on this issue have also issued decisions which recognize bankruptcy courts *as* "courts of the United States." See In re Yochum, 89 F.3d 661 (9th Cir. 1996); In re Germaine, 152 B.R. 619 (B.A.P. 9th Cir. 1993); In re Chambers, 140 B.R. 233 (N.D. Ill. 1992).

5. The objecting parties repeatedly suggest that the trustee could easily have complied with Rule 9011's safe harbor provision, but do not demonstrate how that compliance could have occurred. The statements and arguments of counsel were made throughout numerous pleadings and oral arguments, over a period of some months. The Rosenthal, Rosenthal, Rasco, Stok & Wolf firm also suggests that had the notice been given, it might have been possible for the firm to take steps to correct the problem. However, Rule 9011 makes no provision for service of the safe harbor notice upon the law firm itself, and it is far more logical that such notices would have been served instead upon the individual attorney.

6. Further, the Supreme Court has clearly stated that the inherent power is not limited to situations where the conduct at issue is not covered by another rule or statute. A federal court is not "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules." Chambers, 501 U.S. at 50, 111 S. Ct. at 2135-36.

7. The objecting parties also complain about the trustee's purported "delay" in bringing the sanctions motion. Given the hotly contested nature of this case, the allegation of delay is not well taken. There has never been any significant period of time in which the parties have not been engaged in heated litigation, and the objecting parties had notice that their course of conduct might result in some form of sanction if their behavior crossed the line from zealous advocacy to manipulation of the judicial system. Further, they have failed to document any prejudice which

resulted from this alleged delay. Indeed, the Supreme Court has on occasion indicated that a federal court could consider an award of fees "years after the entry of a judgment on the merits" or even after an action is no longer pending. Cooter v. Gell & Hartmarx Corp., 496 U.S. 384, 395, 110 S. Ct. 2447, 110 L. Ed. 2d 359 (1990).

8. Clearly, such evidence is relevant within the meaning of the Federal Rules of Evidence. See Fed. R. Evid. 401.

9. The Court does agree, however, that Rosenthal, Rosenthal, Rasco's potential liability as a successor entity hinges upon the primary liability of the old firm. Therefore, it appears logical to accept the suggestion that any determination of successor liability await the ultimate evidentiary outcome on the sanctions motion itself.